

2003

**SPECIAL ENROLLMENT
EXAMINATION**



IRS

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Part 4

SPECIAL ENROLLMENT EXAMINATION BOOKLET

**September 18, 2003
1:30 P.M. TO 3:30 P.M.**

**Ethics, Recordkeeping
Procedures, Appeal
Procedures, Exempt
Organizations, Retirement
Plans, Practitioner Penalty
Provisions, Research
Materials and Collection
Procedures**

Official Use Only
(Declassified After September 18, 2003)

Special Enrollment Examination

Part 4

Ethics, Recordkeeping Procedures, Appeal Procedures, Exempt Organizations, Retirement Plans, Practitioner Penalty Provisions, Research Materials and Collection Procedures

Instructions:

The time allotted for this part of the examination is 2 hours. No additional time will be granted. On your answer sheet in the spaces provided you should enter the following:

1. Print your name (First, M.I., Last).
2. Sign your name (First, M.I., Last).
3. Place of examination (City and State).
4. Date of this examination.
5. Print your name (Last, F.I., M.I.) in the boxes provided. Immediately below the boxes darken the oval corresponding to the letter you have printed, as in the sample Name Grid. Darken only one oval in each column below a box in which you have printed a letter. Make no marks in the columns below boxes you have left blank.
6. Enter your candidate number and immediately below, darken the oval corresponding to each number you have entered.
7. Enter your Social Security Number and immediately below, darken the oval corresponding to each number you have entered.

Important:

The answer sheet should not be folded or torn since it will be machine graded.

Read the examination questions carefully. All references are to the Internal Revenue code as amended through December 31, 2002. Unless otherwise stated, all questions relate to the calendar year 2002.

You will be given a No. 2 pencil by the monitor. Darken completely only one oval under the corresponding letter on the answer sheet. In making corrections, erase errors completely.

Scratch paper will be provided, but you may make necessary computations in the questions books. Raise your hand to attract the monitor's attention when you need extra supplies or for permission to leave the room.

!! New procedures!!

All materials must be turned in to the monitor before leaving the room:

Answer sheet: When you finish the examination, your answer sheet must be turned in to the monitor before leaving the room. You must turn in your answer sheet at the end of each test session or your test will not be graded and no credit received. **Answers noted in examination booklets will not be graded.** The examination will be graded in Washington, D.C., by the Office of Professional Responsibility, Internal Revenue Service. You will receive formal notification of your examination results on or about January 31, 2004.

Examination booklets, scratch paper: You must also turn in your examination booklet and scratch paper (used and unused). These materials will be mailed to you after the examination has been administered at all sites.

General Grading Information:

The questions in this examination have been assigned values of 1 to 2 points. All true or false questions have a value of 1 point each and the multiple choice questions in Section B have a value of 2 points each.

The examination is graded on the basis of correct answers. If more than one oval is darkened in answering a questions, the answer will be considered incorrect.

The Service will include the answers with your formal notification of examination results. Therefore, you may want to mark your answers in this examination questions book and retain it for purposes of your future comparison.

Part 4
Section A:
Questions 1 – 40

The following statements are either true or false. Select the most appropriate answer and darken the oval under A for True or B for False.

1. For purposes of Circular 230 (regulations governing practice), the definition of **"tax return"** includes an amended return and a claim for refund.
2. The same practitioner may **not** represent former spouses John and Jane, each claiming their son Jason as a dependent child on their individual tax returns, for audits of those returns.
3. Circular 230 (regulations governing practice), contains special rules for professional conduct with respect to tax shelter opinions.
4. The location of books and records may be a reason for the IRS to grant a taxpayer's request to transfer an examination to an area other than the area in which the taxpayer lives.
5. The law prohibits the IRS from ever reopening an examination of a particular tax year once it has been closed.
6. If the IRS selects a return for audit and the taxpayer responds that they have been audited within the prior five years, the IRS will discontinue the examination.
7. A consent to extend the statute of limitation will stop interest from continuing to accrue during an examinations.
8. If you lived in a location declared by the President of the United States to be a disaster area, after 1996, the IRS will disregard interest on income tax for the length of any extension period granted for filing income tax returns.
9. When a taxpayer and the IRS do not reach agreement on proposed audit changes, the taxpayer may take the case to the Tax Court. If the case is handled under the small tax case procedures, the decision is final and cannot be appealed.
10. For court proceedings resulting from examinations started after July 1998, the IRS has the burden of proof for any factual issue. Therefore, taxpayers are no longer required to maintain records to substantiate items claimed on tax returns.
11. The IRS may not contact third parties such as neighbors, banks, or employers without the taxpayer's written consent.
12. An individual who prepares income tax returns for compensation will **not** be treated as an income tax return preparer under the Internal Revenue Code unless the individual is an enrolled agent, a lawyer, a CPA, or an enrolled actuary.
13. If an income tax return preparer knows or reasonably should have known that the tax on a return he/she prepared is understated due to a position for which there was not a realistic possibility of being sustained on its merits, a penalty of \$250 may be asserted by the IRS.
14. Joe, a contractor, paid an individual \$500 total for subcontract services in tax year 2002, and withheld \$150 in backup withholding. Joe is required to file a Form 1099 MISC.
15. A power of attorney is required when you want to authorize another to represent you at a conference with the IRS, or prepare and file a written response to the IRS.
16. An unenrolled preparer can represent the taxpayer before any function of the IRS.
17. John Bitter wants his associate, Bill Sweet, to be informed about his business tax account. John wants to disclose only this information, and grant no other authority. Form 8821 Tax Information Authorization should **not** be used in this situation because it would allow Bill to represent John.
18. Generally a newly filed power of attorney concerning the same matter does **not** revoke the previous power of attorney. The new representative is automatically added to the list of authorized representatives.
19. A representative may be added to an existing power of attorney by telephoning the IRS service center where the related return or the original power of attorney was filed.
20. A practitioner, who holds a power of attorney, may cash a taxpayer's federal income tax refund check.
21. Generally, an eligible taxpayer, 50 years of age or older, may make both of the following in tax year 2002: A \$3,500 contribution to a traditional IRA, and a \$3,500 contribution to a Roth IRA.
22. Excess contributions to IRA's for tax year 2002 are **not** subject to a penalty if both the excess contribution and earnings are withdrawn before December 31, 2003.
23. An early distribution from an IRA, caused by an IRS levy of the qualified plan, is subject to the early distribution penalty.

24. Jeff, age 30, began participating in a SIMPLE retirement account on January 1, 2001. He took an early distribution from the account on December 1, 2002. He is subject to a 10% penalty on the early distribution.
25. Generally, when a traditional IRA is involved in a prohibited transaction, it is treated as distributing its assets on the date of the transaction.
26. Generally, when a traditional IRA is involved in a prohibited transaction, it is treated as distributing its assets at fair market value on the first day of the year.
27. If you receive a distribution from your employer's qualified plan of any part of the balance of your DEC (voluntary deductible employee contributions) and the earnings from them, you **may** roll over any part of the distribution.
28. Debra, age 30, had established a traditional IRA at her local bank several years earlier. In September, Debra told the custodian to use the amount in her account to buy an annuity contract. The bank sent the annuity contract to her in October. Debra will be taxed on the annuity contract in 2002.
29. Income passed through to a limited partner is treated as compensation for purposes of determining an allowed IRA contribution.
30. Distributions from a Roth IRA must begin no later April 1 of the year following the year the account owner reaches age 70½.
31. Generally, for tax year 2002, up to \$2,000 per year may be contributed to a Coverdell education savings account.
32. Social and recreation clubs may apply and be recognized as exempt from federal income tax.
33. A tax-exempt organization that is required to file Form 990 must file the form by the 15th day of the fifth month following the end of its tax year.
34. A federal tax lien gives the IRS legal claim to the property subject to the lien as security or payment for the tax debt.
35. The tax return for a taxpayer who died within the calendar tax year may be filed electronically.
36. Electronic Return Originators may charge a separate fee for Direct Deposit.
37. Sandy is an Electronic Return Originator. Sandy is required to keep a copy of any signed Forms 8453 Declaration for Electronic Filing signature form until the end of the calendar year in which a return was filed.
38. Rejected electronic return data can generally be corrected and retransmitted without new signatures or authorization if changes are not more than \$50 to total income or AGI.
39. A Refund Anticipation Loan (RAL) is money borrowed by a taxpayer from a lender based on the taxpayer's anticipated income tax refund. The IRS is not involved or responsible for the refund anticipation loan.
40. E-file providers are required to advise their clients that once an electronically filed return is accepted a direct deposit option **cannot** be rescinded.

Turn to the next page for Part 4, Section B

Part 4
Section B
Questions 41 - 80

The following questions are multiple choice. Select the most appropriate answer and darken the oval under the corresponding letter on the answer sheet.

- 41.** Sam is an enrolled agent and a partner in the firm of Taxes-R-Us, LLP. One of Sam's former partners is under investigation by the Office of Professional Responsibility for disreputable conduct. Sam has been asked by the Office of Professional Responsibility to provide information regarding his former partner. Sam must provide all the information requested **unless**:
- A.** He has credible evidence that Sam is not guilty of the disreputable conduct.
 - B.** He believes in good faith and on reasonable grounds that the information requested is privileged or that the request is of doubtful legality.
 - C.** The partnership agreement prohibits him from providing the information. The conduct in question relates to one of Sam's clients.
 - D.** The conduct in question relates to one of Sam's clients.
- 42.** Mike is an enrolled agent. Widget, Inc. is an accrual basis taxpayer. In 2002, while preparing Widget's 2001 return, Mike discovered that Widget failed to include income on its 2000 return that Widget received in 2001, but that should have been included in income in 2000 under the accrual method of accounting. What must Mike do?
- A.** Advise Widget of the error and the consequences of the error.
 - B.** Include the income on the 2001 return.
 - C.** Refuse to prepare Widget's 2001 return until Widget agrees to amend its 2000 return to include the amount in income.
 - D.** Change Widget to the cash method of accounting.
- 43.** John, a CPA, is a sole proprietor of a practice that represents taxpayers in IRS examinations and appeals proceedings. Sally, an enrolled agent, is an associate in John's firm and paid by John as an employee. On February 1, 2003, John is disbarred from practice before the IRS by the Office of Professional Responsibility. What, if anything, must Sally do after John is disbarred?
- A.** Nothing.
 - B.** Quit.
 - C.** Become John's partner.
 - D.** Report all of John's activities to the Office of Professional Responsibility on a quarterly basis.
- 44.** Sandy is an enrolled agent. He is preparing a brochure to hand to prospective clients and would like to explain the designation "enrolled agent." Which of the following language is Sandy **not** permitted to use?
- A.** "I am permitted to practice before the IRS."
 - B.** "I am enrolled to represent taxpayers before the IRS."
 - C.** "I am certified by the IRS."
 - D.** "I am admitted to practice before the IRS."
- 45.** Mike is an enrolled agent. For the past five years, the information that Anne provided Mike to prepare her return included a Schedule K-1 from a partnership showing significant income. However, Mike did not see a Schedule K-1 from the partnership among the information Anne provided to him this year. What does due diligence require Mike to do?
- A.** Without talking to Anne, Mike should estimate the amount that would be reported as income on the Schedule K-1 based on last year's Schedule K-1 and include that amount on Anne's return.
 - B.** Call Anne's financial advisor and ask him about Anne's investments.
 - C.** Nothing, because Mike is required to rely only on the information provided by his client, even if he has a reason to know the information is not accurate.
 - D.** Ask Anne about the fact that she did not provide him with a Schedule K-1.

46. Phil, an enrolled agent, prepares William's income tax return. William gives Phil power of attorney, including the authorization to receive his federal income tax refund check. Accordingly, the IRS sends William's \$100 refund check to Phil's office. William is very slow in paying his bills and owes Phil \$500 for tax services. Phil should:
- A. Use William's check as collateral for a \$100 loan to tide him over until William pays him.
 - B. Refuse to give William the check until William pays him the \$500.
 - C. Get William's written authorization to endorse the check, cash the check, and reduce the amount William owes him to \$400.
 - D. Turn the check directly over to William.
47. Sandra, an enrolled agent, prepares Linda's income tax return. Linda sold some stock in a corporation and believes the proceeds of the stock are all a return to capital, and therefore, not included in her gross income. After research, Sandra determines that there is reasonable basis for Linda's position, but she does not believe there is a realistic possibility of success on the merits. Under what circumstances can Sandra sign Linda's return if the proceeds are **not** included in income reported on the return?
- A. If the position is not frivolous and is adequately disclosed on the return.
 - B. If Sandra documents her disagreement with Linda's position and keeps it in her file.
 - C. If Linda agrees in writing not to dispute any IRS challenge to the position.
 - D. Under no circumstances.
48. A practitioner who is disbarred by the Office of Professional Responsibility may seek reinstatement after:
- A. 1 year.
 - B. 2 years.
 - C. 4 years.
 - D. 5 years.
49. Ray was suspended from practice for four months by the Office of Professional Responsibility. Which of the following is Ray permitted to do during the period of suspension?
- A. Prepare tax returns.
 - B. Sign closing agreements regarding tax liabilities.
 - C. Represent taxpayers before IRS with respect to returns Ray did **not** prepare.
 - D. Sign a consent to extend the statute of limitations for the assessment and collection of tax.
50. Matt, an enrolled agent, provided tax advice to XYZ corporation on a federal tax matter. The Securities and Exchange Commission ("SEC") is reviewing a required filing of the XYZ corporation and asks to see a copy of Matt's tax advice. The tax advice is not protected by the federally authorized tax practitioner privilege under IRC section 7525 from disclosure to the SEC because:
- A. Matt is not a lawyer.
 - B. Matt is not a CPA.
 - C. The federally authorized tax practitioner privilege protects advice only against disclosure to the IRS, not other government agencies.
 - D. The federally authorized tax practitioner privilege protects only advice to individuals.
51. Sam is the sole shareholder in an S corporation. The S corporation was examined and the IRS proposed a \$20,000 deficiency. What **must** Sam do to request an Appeals conference?
- A. File a formal written protest.
 - B. Pay the deficiency.
 - C. Hire a federally authorized tax practitioner to represent the S corporation.
 - D. Nothing because he is eligible for the small case procedure.

- 52.** Which of the following is true regarding “interest netting”?
- A.** The rate of interest charged on the underpayment, up to the amount of the overpayment, will be computed using the overpayment interest rate.
 - B.** The rate of interest charged on the underpayment, up to the amount of the overpayment, will be computed using the underpayment interest rate.
 - C.** Interest is computed by first reducing the underpayment in tax for the year by any overpayment in tax for the year and then computing interest on the net underpayment or net overpayment at the underpayment interest rate.
 - D.** None of the above.
- 53.** The Statutory Notice of Deficiency is also known as:
- A.** A 30-day letter because the taxpayer generally has 30 days from the date of the letter to file a petition with the Tax Court.
 - B.** A 90-day letter because the taxpayer generally has 90 days from the date of the letter to file a petition with the Tax Court.
 - C.** An Information Document Request (IDR) because the taxpayer is asked for information to support its position regarding its liability for tax.
 - D.** A notice and demand because the taxpayer is put on notice that the tax liability is due and owing.
- 54.** The “Small Tax Case” procedures in the Tax Court allow resolution of cases under a set of rules that are simpler than the normal Tax Court procedures. A case may be designated a “Small Tax Case” in the Tax Court, if the amount of tax at issue for each tax year or period is not more than:
- A.** \$50,000.
 - B.** \$100,000.
 - C.** \$125,000.
 - D.** \$150,000.
- 55.** The IRS has the burden of proof for any factual issue in a court proceeding if the taxpayer has:
- A.** Provided credible evidence relating to the issue in a court proceeding.
 - B.** Complied with all substantiation requirements and maintained all required records.
 - C.** Cooperated with all reasonable requests by the IRS for information regarding the preparation and related tax treatment of any item reported on the return.
 - D.** All of the above.
- 56.** Joe, a calendar year taxpayer, filed his federal income tax return, with a refund due, for tax year 2001 on April 1, 2002. The last day to timely file a claim for refund with respect to that return is:
- A.** April 1, 2004.
 - B.** April 15, 2004.
 - C.** April 1, 2005.
 - D.** April 15, 2005.
- 57.** The IRS has begun an examination of Mark’s 2001 income tax return. The IRS would like to ask Mark’s neighbors questions with respect to that examination. There is no pending criminal investigation into the matter and there is no evidence that such contact will result in reprisals against the neighbors or jeopardize collection of the tax liability. Before the IRS contacts the neighbors, the IRS must:
- A.** Provide Mark with reasonable notice of the contact.
 - B.** Make an assessment of Mark’s tax liability.
 - C.** Ask the court for a third-party recordkeeper subpoena.
 - D.** Mail Mark a statutory notice of deficiency.
- 58.** Which of the following is correct regarding a refund check?
- A.** Form 2848, Power of Attorney, may be used to authorize cashing of a refund check.
 - B.** Form 2848, Power of Attorney, may be used to authorize receipt a refund check.
 - C.** Form 8821, Tax Information Authorization must be signed before a refund check may be applied to a fee for electronic filing.
 - D.** Both Form 2848 and Form 8821 must be used to authorize cashing a refund check.

59. Alice and Mike file a joint return for 2002 on April 15, 2003. Alice, who is a nonworking spouse, is 49. Both Alice and Mike contributed \$2,000 each to a traditional IRA although they qualified to contribute the maximum amount. They filed their return timely. On June 1st, 2003, Mike's mother gave each of them \$1,000. What additional amount of the gift may Alice & Mike contribute to each of their IRA's for the year 2002?
- 0.
 - \$1,000.
 - \$500.
 - \$3,000.
60. The use of IRA funds in prohibited transactions can result in additional taxes and penalties. Which of the following is **not** a prohibited transaction in a **traditional IRA**?
- Borrowing money from the IRA.
 - Selling property to an IRA.
 - Inheriting your spouse's IRA.
 - Using an IRA as security for a loan.
61. Generally, which of the following is a prohibited transaction concerning your **traditional IRA**?
- Withdraw funds for qualified higher education expenses.
 - Pledge your IRA account as security for your mortgage.
 - Withdraw funds for qualified medical expenses.
 - Withdraw funds to purchase your first home.
62. Max, a fiduciary, pledged his client's traditional IRA of \$300,000 as security for a loan. If Max is found liable for engaging in a prohibited transaction, what is the minimum penalty he is most likely to pay if the transaction is **not** corrected?
- \$45,000.
 - \$30,000.
 - \$36,000.
 - \$300,000.
63. The SIMPLE 401(K) plan is a qualified retirement plan. The SIMPLE is **not** subject to nondiscrimination and top-heavy rules if the plan meets all of the conditions **except**:
- Under the plan, the employee may choose salary reduction contributions to a trust up to \$7,000 for 2002.
 - Participants age 50 and over can make a catch-up contribution up to \$500.
 - Employers must make matching contributions of 3% of compensation for the year or non-elective contributions of 2% of compensation on behalf of each eligible employee who has at least \$5,000 of compensation from his employer for the year.
 - The employee's rights to any contributions are forfeitable.
64. Joe (single, age 51) wants to defer the **maximum** amount possible to his 401(k) plan. What is the amount of basic and catch-up contributions he may make for tax year 2002?
- \$11,000.
 - \$41,000.
 - \$25,000.
 - \$12,000.
65. Sam received a total distribution of \$40,000 from his employer's 401(K) plan consisting of \$25,000 in cash, and land with a fair market value of \$15,000. If Sam decides to keep the land, what is the total amount that he can roll over to his IRA?
- Sam may substitute \$15,000 of his own funds for the property and consider his rollover to be \$40,000 in cash.
 - Sam can roll over only \$15,000 the value of the land he received.
 - Sam can roll over the \$25,000 cash received into his IRA.
 - Sam is required to sell the land before any part of the distribution can be rolled over.
66. The 2002 basic limit on elective deferrals in 401(k) plans (excluding SIMPLE plans) for participants **under** age 50 is:
- \$7,000.
 - \$10,500.
 - \$11,000.
 - \$12,000.

67. In 2002, MaryAnn, a nonworking spouse, files a joint return with Jack who is not covered by a pension plan at work. Their AGI is \$50,000 and Jack plans to contribute \$3,000 to a traditional IRA. MaryAnn who is 51 wishes to contribute to an IRA. What is the maximum amount she can contribute?
- \$3,000.
 - \$2,000.
 - \$3,500.
 - \$2,500.
68. Sally, age 38, converted \$14,000 from her traditional IRA to a Roth IRA in 2002. When she had her tax return prepared for 2002, her tax professional informed her the conversion was not allowed because her income was \$300,000. If she **does not** do a recharacterization by April 15, 2003 what are her consequences?
- Pay tax and a 10% penalty on all of the \$14,000 conversion, plus a 6% penalty on the full \$14,000.
 - Pay a 6% penalty only on the full \$14,000.
 - Pay tax only on the full \$14,000.
 - Pay tax and a 10% penalty on \$11,000.
69. Kimberly, age 30, a full-time student with no taxable compensation, married Michael, age 30, during 2002. For the year, Michael had taxable compensation of \$35,000. He plans to contribute and deduct \$3,000 to his traditional IRA. If he and Kimberly file a joint return, how much may each deduct in 2002 for contributions to their individual traditional IRA's and what is the compensation Kimberly uses to figure her contribution limit?
- | IRA deduction | Compensation for Kimberly
To Figure IRA Contribution Limit |
|---------------|---|
| A. \$3,000. | \$32,000. |
| B. \$3,000. | \$35,000. |
| C. \$2,500. | \$35,000. |
| D. \$2,000. | \$32,500. |
70. To recharacterize the Roth IRA back to a traditional IRA, you must do the following:
- Withdraw the earnings as only the principal investment is eligible.
 - A trustee-to-trustee transfer, including the income earned, if any.
 - Request written permission from the IRS.
 - File Form 5329 to pay the penalty on the earnings.
71. Morris, a single taxpayer is not covered by a qualified plan at his place of employment. He wishes to establish an IRA and contribute \$3,000 for 2002. An IRA may be invested in all of the following accounts **except**:
- Bank CD.
 - Mutual Fund.
 - Annuity.
 - Artwork.
72. John, a self-employed taxpayer, has a SEP plan for his business. He has three eligible employees, Sara (age 35), Joseph (age 37), and Jean (age 45), who have worked for him for the past 10 years. For the year 2002, Sara earned \$15,000, Joseph earned \$25,000, and Jean earned \$30,000. He wants to elect the 25% contribution rate so he can put as much as possible in for himself. If he elects 25%, how much must he contribute to the plan for his employees?
- \$0.
 - \$2,100.
 - \$17,500.
 - \$40,000.
73. Mike is self-employed. He is a calendar year taxpayer. If he wants to set up a SEP plan for his business for the year 2002, he must do so by (including Extensions):
- December 31, 2002.
 - January 31, 2003.
 - April 15, 2003.
 - October 15, 2003.
74. Generally, an IRA contribution is limited to the lesser of \$3,000 in 2002, or the taxpayer's compensation. However, which of the following items is **not** treated as compensation for this limitation:
- Wages earned by an individual under the age of 18.
 - Taxable alimony.
 - Self-employment loss.
 - Commissions.
75. John failed to take required minimum distributions from his traditional IRA. The excess accumulation is subject to a penalty of:
- 6%.
 - 10%.
 - 15%.
 - 50%.

- 76.** Which of the following organizations may request exempt status under the Internal Revenue Code as charitable organizations?
- A.** Religious organization.
 - B.** School.
 - C.** Animal welfare organization.
 - D.** All of the above.
- 77.** Generally, how long does the IRS have to collect outstanding federal taxes?
- A.** 10 years from the due date of the return.
 - B.** 10 years from the date the return is filed.
 - C.** 10 years from the date of the notice of deficiency.
 - D.** 10 years from the date of assessment.
- 78.** Which of the following is true with respect to an offer in compromise?
- A.** The taxpayer may be allowed to pay less than the full amount owed.
 - B.** Collection actions, such as levy, may be delayed.
 - C.** A rejected offer may be appealed.
 - D.** All of the above.
- 79.** Which of the following is an acceptable method of computation for an Electronic Return Originator fee?
- A.** Fees based on time required for preparation.
 - B.** Fees based on AGI from the tax return.
 - C.** Fees based on percent of refund.
 - D.** Flat fee identical for all customers.
- 80.** The contractual agreement for a Refund Anticipation Loan (RAL) is between which of the following?
- A.** Taxpayer and lender.
 - B.** Taxpayer and electronic filing provider.
 - C.** Electronic filing provider and the lender.
 - D.** IRS and the taxpayer.

End of Part 4

